MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2017/2018

BFN3034 – BEHAVIOURAL FINANCE
(All Sections / Groups)

30 MAY 2018
9.00AM – 11.00A.M
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This questions paper consists of 2 pages.

2. Answer **ALL** questions. The marks for each question are given in the question paper.

3. Please write your answers for all the questions in the answer booklet.

Answer ALL questions.

Question 1

(a)   Identify one behavioural bias or trait that is most exhibited from statement (i) to (iii) below.

    (i)   Ahmad Mazuki has carefully analysed the historical data and concluded that recessionary environments occur on average 20% of the time. Ahmad has incorporated this probability into his strategic asset allocation recommendations. When new information is presented by a co-worker showing that the actions of the central bank significantly affect the recession probabilities and that the new head of the central bank has announced tightening monetary conditions, Ahmad goes on vacation without making any adjustments to his work.   **(5 marks)**

    (ii)   Las Vegas casinos have found that gamblers are far more likely to take big risks with money that they have won from the casino. Also, casinos have found that gamblers are not as upset about losing house money as they are about losing their own gambling money. But, this separation is plainly irrational.   **(5 marks)**

    (iii) Kahneman, Knetsch, and Thaler (1990) conducted pilot studies where participants were given a mug and then offered the chance to sell it or trade it for an equally priced alternative good (pens). The results showed the pen and mug to be equally preferred (50% of people prefer pen, 50% prefer mug). But when subjects are actually given one item, and then given the opportunity to trade, only 10% traded.   **(5 marks)**

(b)   Explain the main concept of the illusion of control and its causes. Then, discuss the impacts of the illusion of control of an individual as well as how an individual can mitigate the impacts on investment decision making.

(12 marks)

(c)   Briefly discuss how cognitive errors differ from emotional biases. List any four cognitive errors which arise due to behavioural perseverance.

(8 marks)

(Total: 35 marks)

Continued...

Question 2

(a)   (i)   Discuss the noise trader in Shleifer's model and the possibility of noise trader financial success.   **(5 marks)**

        (ii)   Discuss the critics of Shleifer model on unlimited arbitrage as assumed in the efficient market hypothesis.   **(5 marks)**

(b)   Prospect theory was created in 1979 by Daniel Kahneman and Amos Tversky. It is one of the most often quoted and best documented phenomena in economic psychology. Hence, you are required to:

        (i)   Describe the main concepts of the Prospect theory.   **(5 marks)**

        (ii)   Discuss how Prospect theory deviates from expected utility theory.

                                  (8 marks)

        (iii)   Describe framing effects in the prospect theory.   **(7 marks)**

(Total: 30 marks)

Question 3

(a)   Linda is 31 years old, single, outspoken, and very bright. She majored in philosophy. As a student, she was deeply concerned with issues of discrimination and social justice, and also participated in anti-nuclear demonstrations. About 90% of survey respondents choose Linda as bank teller and active in the feminist movement.

        (i)   Discuss whether the choice is correct or not.   **(2 marks)**

        (ii)   Explain the fallacy that is most appropriate in this case.   **(7 marks)**

(b)   The representativeness heuristic leads to a series of judgment errors. Discuss the misconception of chance and misconceptions of regression.   **(12 marks)**

(c)   (i)   Describe what is meant by market sentiment.   **(4 marks)**

        (ii)   When market sentiment index (MSI) is 1.0, as an investor, what should you do?   **(2 marks)**

(d)   Choose ONLY ONE (1) of the following to discuss the behavioural biases and its impacts on investment decision making. You may use an example to illustrate.

        (i)   Overconfidence bias; or

        (ii)   Availability bias; or

        (iii)   Mental accounting.

                                  (8 marks)

(Total: 35 marks)

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